

**BEFORE  
THE PUBLIC SERVICE COMMISSION OF  
SOUTH CAROLINA  
DOCKET NO. 2004-357-WS**

IN RE:

Application of Carolina Water Service,  
Inc. for adjustment of rates and charges  
and modification of certain terms and  
conditions for the provision of water and  
sewer service.

**DIRECT TESTIMONY  
OF  
STEVEN M. LUBERTOZZI**

**Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS  
FOR THE RECORD.**

**A.** My name is Steven M. Lubertozzi. I am employed as the Director of Regulatory  
Accounting at Utilities, Inc., 2335 Sanders Road, Northbrook, Illinois 60062.

**Q. WHAT IS YOUR PROFESSIONAL BACKGROUND?**

**A.** I have been employed by Utilities, Inc. since June of 2001. Since that time I have  
been involved in many phases of rate-making in several regulatory jurisdictions. I  
graduated from Indiana University in 1990, with a bachelors degree and am a Certified  
Public Accountant. I had four years of public accounting/financial analysis experience  
prior to joining Utilities, Inc., and I am a member of the American Institute of Certified  
Public Accountants. I have successfully completed the Eastern Utility Rate School that  
NARUC and Florida State University co-sponsor and I have testified in rate adjustment  
cases before this Commission as well as the state utility regulatory commissions in  
Illinois, Indiana, Florida, Maryland, New Mexico, and North Carolina.

1  
2 **Q. PLEASE EXPLAIN YOUR JOB RESPONSIBILITIES AT UTILITIES, INC.**

3 A. My responsibilities encompass all aspects of utility commission regulation in  
4 sixteen of the states where Utilities, Inc. operates (Georgia does not regulate water and  
5 sewer utilities). These duties include preparation of rate case applications, coordinating  
6 Commission audits, developing and delivering testimony before utility commissions,  
7 obtaining commission approval of territory expansions, utility system transfers,  
8 participation in rulemaking proceedings, and keeping apprised of industry trends and  
9 current events.  
10

11 **Q. PLEASE DESCRIBE CAROLINA WATER SERVICE, INC.**

12 A. Carolina Water Service, Inc., which I will sometime refer to as "CWS" or the  
13 "Company", is a wholly owned subsidiary of Utilities, Inc. CWS was incorporated in  
14 1972 for the purpose of owning and operating water and wastewater utility systems.  
15 Since that time, CWS has grown to serve approximately 5,700 water connections and  
16 9,800 wastewater connections. These customers are located in eleven counties across the  
17 state. CWS maintains an operations and customer service office in West Columbia.  
18 Customer payments, meter readings and service orders are processed from the West  
19 Columbia office. Administrative functions such as management, accounting, data  
20 processing and human resources are performed from the Utilities, Inc. office in  
21 Northbrook, Illinois.  
22

23 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

24 A. The purpose of my testimony is to sponsor the Company's application for an  
25 adjustment of certain rates and charges for the provision of water and sewer services.  
26

27 **Q. THE APPLICATION ALSO SEEKS APPROVAL FOR A MODIFICATION FOR**  
28 **CERTAIN TERMS AND CONDITIONS OF PROVIDING THESE SERVICES,**  
29 **DOES IT NOT?**

1 A. Yes, but Mr. Haas will present testimony supporting the Company's request in  
2 that regard.  
3

4 **Q. WHY IS CWS REQUESTING RATE RELIEF AT THIS TIME?**

5 A. For the test year ended June 30, 2004, CWS earned a 5.70% return on its rate  
6 base, which is nearly half of the rate of return on rate base authorized in the Company's  
7 last rate case over three and one half years ago. The Company's current return on rate  
8 base is also well below its cost of capital which, as the Commission will hear from the  
9 Company's witness Mrs. Ahern, is 11.40% to 11.50%. Capital will become more costly  
10 and eventually unavailable without adequate relief. According to statistics compiled by  
11 the United States Department of Labor Bureau of Labor Statistics, the cost of water and  
12 sewer maintenance has increased approximately 4.275% per year since the Company's  
13 last rate case. The Company's per book operating expenses alone have increased by  
14 nearly one million dollars since its last rate case. Without rate relief, CWS would  
15 become unable to meet its financial obligations. Such a scenario places in jeopardy the  
16 Company's ability to continue to provide safe, reliable and efficient water and sewer  
17 utility services to its customers.  
18

19 **Q. PLEASE DESCRIBE THE COMPANY'S APPLICATION.**

20 A. In addition to the proposed rate schedule, the Application contains financial  
21 statements consisting of a balance sheet, income statements, rate base and rate of return  
22 calculation, a test year revenue calculation under current rates, a revenue calculation  
23 under proposed rates, and a schedule of current and projected customers. Also included  
24 are the most recent approval letters from DHEC and a sample customer bill form.  
25

26 **Q. WOULD YOU PLEASE SUMMARIZE THE PROPOSED RATE CHANGES IN**  
27 **THE COMPANY'S WATER RATE SCHEDULE?**

28 A. The proposed changes to the Company's water rate schedule would increase the  
29 Residential Base Facility Charge, or BFC, from \$10.00 to \$10.25 per month for a

1 residential unit, with the BFC for commercial customers being increased proportionally  
2 depending on the size of their water meter. The increase in the Base Facility Charge  
3 applies both to the full-service customers and the distribution-only customers. The  
4 proposed changes to the water rate schedule would increase the commodity charge from  
5 \$3.24 per thousand gallons of water consumed to \$3.32 per thousand gallons of water  
6 consumed by a full service customer. For water customers receiving distribution only  
7 service, the proposed change in water commodity charge would be to increase it from  
8 \$1.85 to \$1.90 per thousand gallons consumed.  
9

10 **Q. WHAT IS THE IMPACT OF THE PROPOSED WATER RATE CHANGES?**

11 **A.** The proposed increase in water charges, both BFC and commodity, is  
12 approximately 2.5%. In terms of dollars and cents, the requested increase in water  
13 charges for an average full service customer is \$0.73, which is based on an average water  
14 consumption of 5,900 gallons per month.  
15

16 **Q. PLEASE SUMMARIZE THE PROPOSED RATE CHANGES TO THE**  
17 **COMPANY'S SEWER RATE SCHEDULE.**

18 **A.** The Company proposes to increase the full-service sewer charge for customers  
19 located outside the Company's Lincolnshire, I-20, Watergate, Kings Grant and Teal-on-  
20 the-Ashley service areas from \$30.33 to \$40.92 per month. Rates for customers in the  
21 areas I just mentioned would increase from \$28.86 to \$40.92. The monthly fee for  
22 Mobile Homes in all areas would increase from \$21.64 to \$29.20. Monthly charges for  
23 collection-only customers in all areas are proposed to be increased from \$19.38 to \$26.15  
24 per residential unit or single family equivalent.  
25

26 **Q. WHAT IS THE IMPACT OF THE PROPOSED SEWER RATE CHANGES?**

27 **A.** For customers located outside the five specific service areas I just mentioned, the  
28 proposed sewer increase is \$10.59 per month, or approximately 35%. For sewer  
29 customers in Lincolnshire, I-20, Watergate, Kings Grant and Teal-on-the-Ashley, the

1 proposed increase is \$12.06, or approximately 41%. For mobile home customers, the  
2 increase is \$6.45, or approximately 35%. For sewer collection only customers the  
3 increase is \$6.77, or approximately 35%.

4  
5 **Q. WHY IS THE COMPANY SEEKING A GREATER INCREASE FOR SEWER**  
6 **CUSTOMERS IN THE LINCOLNSHIRE, I-20, WATERGATE, KINGS GRANT**  
7 **AND TEAL ON THE ASHLEY PORTIONS OF ITS SERVICE AREA THAN FOR**  
8 **ITS OTHER CUSTOMERS?**

9 **A.** The Company believes that uniform rates across its entire customer base are more  
10 appropriate when possible. Customers in these areas were not included in the sewer rate  
11 increase approved by the Commission in the Company's last rate case in 2001. At the  
12 time our last rate application was pending, the Company learned that the Lexington  
13 County Joint Municipal Water and Sewer Commission was attempting to condemn our I-  
14 20 sewer and Watergate water systems. The Lincolnshire sewer system was also the  
15 subject of litigation arising out of an effort by the Department of Health and  
16 Environmental Control ("DHEC") to require the Company to interconnect with the  
17 Georgetown County Water and Sewer District. These three systems were also operating  
18 on expired NPDES permits which had not been renewed, in part, because of the  
19 uncertainty with respect to how customers in these areas would be served in the future.  
20 Given the uncertainty with respect to those systems, the Company did not propose to  
21 increase rates for customers served by those systems. In its order in that case, the  
22 Commission determined that similar uncertainties existed with respect to customers in  
23 Kings Grant and Teal on the Ashley because CWS's treatment facility for that area was  
24 also operating under an expired NPDES permit. Based upon that determination, the  
25 Commission excluded our Kings Grant and Teal on the Ashley customers from the 2001  
26 rate increase.

27  
28 **Q. DO NOT SOME OF THOSE SAME UNCERTAINTIES CONTINUE TO EXIST**  
29 **TODAY?**

1 A. Yes, they do. However, the Company reasonably believed during the last rate  
2 case that some final resolution of the uncertainties with respect to I-20, Watergate and  
3 Lincolnshire would have been reached before our next rate filing. Since they have not  
4 been finally resolved, we believe it appropriate to move forward with a rate application  
5 which will provide for uniform rates.  
6

7 **Q. MR. LUBERTOZZI, WERE THE FINANCIAL STATEMENTS ATTACHED TO**  
8 **THE APPLICATION PREPARED BY YOU OR UNDER YOUR DIRECTION?**

9 A. Yes. They are attached as Exhibit B to the application.  
10

11 **Q. WHAT IS CONTAINED IN THE FINANCIAL STATEMENTS?**

12 A. The test year chosen by the Company is the year ended June 30, 2004. This was  
13 the most recent twelve-month period for which full data was available at the time of the  
14 Company's filing in December of 2004. Schedule A is the Balance Sheet as of June 30,  
15 2004. At the end of the test year, CWS had assets of approximately \$34 million. This  
16 includes approximately \$32 million of Net Utility Plant. Schedule B is the Income  
17 Statement for the test year and is comprised of an Income Statement for Combined  
18 Operations, Water Operations, and Sewer Operations, and a list of brief explanations for  
19 the pro forma adjustments made to these Income Statements. As I mentioned before, the  
20 Company's per book operating expenses, with an adjustment for property taxes I will  
21 describe, are nearly \$1,000,000 more than the operating expenses allowed in the last rate  
22 case. With the pro forma adjustments proposed in Schedule B and in my testimony, the  
23 Company has experienced an increase in operating expenses of over \$1.45 million since  
24 its last rate case. The increase in expenses contributes to the Company's need for rate  
25 relief.

26 Schedule C is the Rate Base and Rate of Return Statement for Combined  
27 Operations, Water Operations, and Sewer Operations. Schedule D is the Consumption  
28 Analysis under present rates and is comprised of two pages, one reflecting the calculation  
29 of water revenues at present rates and the second reflecting the calculation of sewer

1 revenues at present rates. Schedule D has been revised to correct billing units and gallons  
2 consumed. Schedule E reflects the same calculations under Proposed Rates. The billing  
3 units contained on Schedule E have also been revised. I apologize if these revisions have  
4 caused any of the parties any inconvenience. Of course, the revisions, which were filed  
5 on March 15, 2005, were needed to make certain that the Commission has the most  
6 accurate financial information. The revised Schedules D and E and all documentation  
7 supporting the revisions was provided to Office of Regulatory Staff during the course of  
8 their Business Compliance Audit.

9  
10 **Q. WOULD YOU PLEASE PROVIDE A BRIEF EXPLANATION OF THE PRO**  
11 **FORMA ADJUSTMENTS INCLUDED ON SCHEDULE B?**

12 **A.** Operator and Office Salaries were annualized as of June 30, 2004. Pension &  
13 Other Benefits were annualized to match end of test year salaries and wages. Regulatory  
14 Commission Expense was adjusted to reflect the cost of this proceeding amortized over a  
15 three-year period. Depreciation Expense was adjusted to reflect the annualized  
16 depreciation expense on end of test year plant as well as pro forma additions to plant.  
17 Taxes Other Than Income have been adjusted for changes in the payroll taxes based on  
18 current tax rates and annualized salary figures as discussed above. In addition, the  
19 Regulatory Commission Tax was adjusted to an estimated increase in the assessment by  
20 the PSC. Gross Receipts Taxes were annualized on revenues under present and proposed  
21 rates. State and Federal Income taxes were calculated at the current rates of 5% and 34%,  
22 respectively. AFUDC is eliminated for ratemaking purposes. Interest Expense was  
23 synchronized using the capital structure of the consolidated Utilities, Inc. group of  
24 companies, consisting of a debt / equity ratio of 59.23% / 40.77% and an embedded cost  
25 of debt of 7.28%. Where applicable, adjustments have been made to expense categories  
26 to reflect increases in the cost of water and sewer maintenance based upon the Bureau of  
27 Labor statistics I have already mentioned. An extraordinary retirement expense directed  
28 by the Commission for wells no longer in service is included. And, an expense

1 adjustment is made to reflect the acquisition of new vehicles purchased for additional  
2 employees.

3  
4 **Q. YOU MENTIONED A PRO FORMA PROPERTY TAX EXPENSE**  
5 **ADJUSTMENT THAT THE COMPANY PROPOSES; IS THIS ALSO**  
6 **REFLECTED ON SCHEDULE B?**

7 A. No, it is not, but I am proposing that such an adjustment be made.

8  
9 **Q. WOULD YOU PLEASE DESCRIBE THIS ADJUSTMENT?**

10 A. Yes. During the course of the ORS financial audit, CWS discovered that the test  
11 year property tax account was understated by \$264,492. This understatement was due to  
12 a reversal of a prior period's accrual. A review of the Company's general ledger will  
13 reveal a credit in account 4081100 -- Property & Other General Taxes with no offsetting  
14 debit in any expense account. This credit, with out the corresponding debit, is a reduction  
15 to Company's expenses.

16  
17 **Q. WHEN WAS THE ORIGINAL ACCRUAL RECORDED ON THE COMPANY'S**  
18 **GENERAL LEDGER?**

19 A. The original accrual or debit was recorded in June of 2003, one month prior to the  
20 start of the test year.

21  
22 **Q. WAS THIS REVERSAL OF A PRIOR PERIOD'S ACCRUAL DISCUSSED WITH**  
23 **THE ORS STAFF?**

1 A. Yes. This journal entry was discussed with the ORS Staff on several occasions  
2 during the audit and I have since discussed it with ORS Staff. The original accrual was  
3 provided to ORS along with the test year reversal and I explained to ORS Staff our belief  
4 that the test year reversal of \$264,492 did not belong in the test year.

5  
6 **Q. HOW SHOULD THIS PROPERLY BE TREATED FOR RATEMAKING**  
7 **PURPOSES?**

8 A. The reversal of \$264,492 should be removed and operating expenses adjusted to  
9 reflect this actual test year expense for rate making purposes. This will allow the Utility  
10 to properly recover expenses incurred during the test period. If the reversal remains in  
11 the Company's test year expenses for ratemaking purposes, the Company's revenue  
12 requirement and resulting rate of return will be significantly lower than that which is  
13 appropriate.

14  
15 **Q. WHAT WAS THE REACTION OF ORS STAFF TO THIS PROPOSED**  
16 **ADJUSTMENT?**

17 A. I believe that ORS Staff agrees with it, but I understand that it will be providing a  
18 comprehensive report to the Commission on its audit.

19  
20 **Q. WHAT IS CONTAINED IN SCHEDULE C?**

21 A. Schedule C is the Rate Base and Rate of Return Statement. As of June 30, 2004,  
22 CWS has a rate base of approximately \$15,639,000. This compares to a rate base of  
23 approximately \$11,500,000 at the end of the test year in the last rate case as approved by  
24 the Commission. This increased investment has contributed to the need for rate relief.

1 As indicated on page 1 of Schedule C, CWS earned a 5.70% return on rate base during  
2 the test year. This is below the Company's cost of capital.  
3

4 **Q. WHAT PRO FORMA ADJUSTMENTS ARE REFLECTED ON SCHEDULE C?**

5 **A.** There are several. Working capital has historically been used in CWS rate cases  
6 and is again used in this proceeding. Working capital is calculated at one-eighth of test  
7 year operating expenses. A pro forma adjustment is made to working capital to match the  
8 pro forma operating expenses. Another rate base adjustment indicated on Schedule C is  
9 to recognize plant additions made after June 30, 2004. Similarly, an adjustment is also  
10 made to reflect capital projects that were either underway but not yet complete as of the  
11 end of the test year or which are planned. These uncompleted and planned pro forma  
12 plant projects are needed to provide customers with safe and reliable water and sewer  
13 service. A capitalized time adjustment and new vehicle adjustment is also included.  
14 Negative adjustments include removal of wells as directed in the Company's last rate  
15 case and the elimination of excess book value. Accumulated depreciation is adjusted to  
16 reflect the impact of the other adjustments.  
17

18 **Q. IF THE ADJUSTMENT TO PROPERTY TAXES YOU DISCUSSED EARLIER**  
19 **WERE TO BE GIVEN EFFECT, WOULD THAT HAVE AN IMPACT UPON**  
20 **THE RATE OF RETURN ON RATE BASE CALCULATIONS SET OUT IN**  
21 **SCHEDULE C?**

22 **A.** Yes. With that adjustment, the Company's return on rate base for the test year, as  
23 adjusted, and at proposed rates would be even lower.  
24

25 **Q. WHAT RATEMAKING METHODOLOGY DOES THE COMPANY PROPOSE**  
26 **THAT THE COMMISSION EMPLOY IN THIS CASE?**

27 **A.** The Company proposes that its rates be determined utilizing the rate of return on  
28 rate base methodology.  
29

1 **Q. IS RATE OF RETURN ON RATE BASE TREATMENT APPROPRIATE FOR**  
2 **THE COMPANY?**

3 **A.** Absolutely. The Company has a large rate base and needs to earn a rate of return  
4 that is sufficient to obtain the necessary equity and debt capital that a larger utility needs  
5 for sound operation.  
6

7 **Q. MR. LUBERTOZZI, DOES THE COMPANY SEEK TO INCLUDE ANY**  
8 **PAYMENTS TO AFFILIATED ENTITIES?**

9 **A.** Yes. Included in the Company's test year expenses and included in capital  
10 expenditures are payments to Bio-Tech, Inc. Bio-Tech is a South Carolina corporation  
11 which, like CWS, is a wholly-owned subsidiary of Utilities, Inc. Bio-Tech's business  
12 focuses on two primary services, one of which is sludge hauling and disposal and the  
13 other being wastewater plant maintenance, repair and construction. The Company uses  
14 both of these services, although the sludge hauling and disposal service comprises the  
15 majority of our payments to Bio-Tech. The sludge disposal portion of Bio-Tech's  
16 business is regulated by DHEC, which has issued a land application permit for Bio-  
17 Tech's disposal site on Old State Road in Lexington County.  
18

19 **Q. DOES BIO-TECH PROVIDE SERVICES ONLY TO THE COMPANY AND**  
20 **OTHER WHOLLY-OWNED SUBSIDIARIES OF UTILITIES, INC.?**

21 **A.** No. Bio-Tech also serves other public utilities and governmentally owned  
22 utilities such as municipalities, counties, special purpose districts and public service  
23 districts.  
24

1 **Q. HOW ARE BIO-TECH'S CHARGES FOR SERVICES TO THE COMPANY**  
2 **DETERMINED?**

3 **A.** Bio-Tech charges the Company the same rates it charges to any other similarly  
4 situated customer. The per mile rate and disposal charges paid by CWS is the same as it  
5 is for any other customer, whether it is affiliated with the Company or not. Bio-Tech's  
6 charges for wastewater plant maintenance, repair and construction are the same for all of  
7 its customers, both affiliated and unaffiliated.

8  
9 **Q. WERE THERE ANY BIO-TECH EXPENSES INCLUDED IN THE COMPANY'S**  
10 **LAST RATE PROCEEDING?**

11 **A.** Yes. The rates set in the Company's last rate case included expenditures paid to  
12 Bio-Tech. This was also true for another Utilities, Inc. operating subsidiary in South  
13 Carolina, United Utility Companies, Inc., which has received rate relief from the  
14 Commission since CWS's last rate case.

15  
16 **Q. WOULD NOT THE EXPENSES ASSOCIATED WITH THE SERVICES**  
17 **PROVIDED TO THE COMPANY BY WATER SERVICE CORPORATION**  
18 **ALSO CONSTITUTE AFFILIATE PAYMENTS?**

19 **A.** No, they would not because there are no payments involved, only expense  
20 allocations. As the Commission knows from the nearly thirty years worth of rate cases it  
21 has considered involving the Company and other affiliates of Utilities, Inc., Water  
22 Service Corporation, or WSC, is a wholly owned subsidiary of Utilities, Inc. that

1 provides management services to CWS and other operating subsidiaries in the sixteen  
2 states where Utilities, Inc. has operations. WSC is captive in the sense that its services,  
3 which include management, payroll, tax, accounting, procurement services, are only  
4 provided to subsidiaries of Utilities, Inc. As the Commission's decisions through the  
5 years accepting this arrangement reflect, it is cost efficient since it avoids duplication of  
6 these services and functions for each operating subsidiary. This conclusion is tested in  
7 each rate case by an audit of the allocations and the records of WSC.  
8

9 **Q. MR. LUBERTOZZI, WHAT INCREASE IN SEWER RATES DOES THE**  
10 **APPLICATION PROVIDE FOR MIDLANDS UTILITY, INC.?**

11 **A.** The proposed rate schedule provides for an increase in our monthly sewer rate for  
12 commercial customers to \$40.92 per single family equivalent. Under normal  
13 circumstances, Midlands would be a commercial customer under the definition contained  
14 in section one of the proposed sewer rate schedule. However, Midlands currently pays  
15 the Company only \$11 per single family equivalent for bulk service provided for the  
16 Vanarsdale Subdivision in Midlands' service area pursuant to a contract approved by the  
17 Commission in 1995 in its Docket No. 95-1151-S. Thus, the bulk rate applicable to  
18 Midlands has not changed in over nine years. The Company recognizes, however, that  
19 Midlands has recently requested a pass-through rate for its collection only customers  
20 which, if approved, would mean that an increase from \$11 to \$40.92 , or \$29.92 per  
21 month, would be imposed on Midlands' customers. Given these unusual circumstances,  
22 the Company proposes that Midlands be charged \$29.68 per single family equivalent, as

1 is reflected in revised Schedule E of Exhibit "B" to the application. This would  
2 constitute an increase of approximately 170% and approximates the rate proposed to be  
3 charged to mobile home customers. This rate also reflects some reduction from the  
4 standard commercial rate to take into account the fact that Midlands will be collecting  
5 and delivering the wastewater for the approximately 412 Midlands customers located in  
6 Vanarsdale.

7  
8 **Q. IS THE \$29.68 PER SINGLE FAMILY EQUIVALENT RATE FOR MIDLANDS**  
9 **UTILITY THE ONLY RATE WHICH CWS BELIEVES WOULD BE JUST AND**  
10 **REASONABLE?**

11 **A.** No, it is not. As long as the Commission sets rates which allow the Company to  
12 earn a fair rate of return and allows recovery of the Company's expenses, another rate for  
13 Midlands could be found to be just and reasonable. In the end, this is really a rate design  
14 question which the Commission may address if it so chooses. The only concern that the  
15 Company would have is that any reduction in rates for Midlands, which is our only bulk  
16 customer, will necessarily mean that other customers would have to bear a greater portion  
17 of the revenue requirement and expenses supporting increased rates.

18  
19 **Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

20 **A.** Yes, it does.